No. 93-489

IN THE

Supreme Court of the United States

OCTOBER TERM, 1993

O'MELVENY & MYERS, a Law Partnership,
Petitioner,

v.

FEDERAL DEPOSIT INSURANCE CORPORATION AS RECEIVER FOR AMERICAN DIVERSIFIED SAVINGS BANK, ADC FINANCIAL CORPORATION, AMERICAN DIVERSIFIED/WELLS PART II, AND AMERICAN DIVERSIFIED/GATEWAY CENTER,
Respondents.

On Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

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BRIEF *AMICUS CURIAE* OF SECURITIES INVESTOR PROTECTION CORPORATION, EUGENE W. BELL AS TRUSTEE FOR THE LIQUIDATION OF JOSEPH SEBAG, INC., AND LAURENCE A. SCHROEDER AS SUCCESSOR TRUSTEE FOR THE LIQUIDATION OF FIRST STATE SECURITIES CORPORATION, IN SUPPORT OF RESPONDENTS

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14 pp

TABLE OF CONTENTS

TABLE OF AUTHORITIES

Table of Authorities Continued

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BRIEF *AMICUS CURIAE* IN SUPPORT OF RESPONDENTS

PRELIMINARY STATEMENT

The Securities Investor Protection Corporation ("SIPC"), Eugene W. Bell as Trustee for the Liquidation of Joseph Sebag, Inc., and Laurence A. Schroeder as Successor Trustee for the Liquidation of First State Securities Corporation submit this brief as *amici curiae* in support of Respondents and urge this Court to affirm the opinion and judgment of the United

States Court of Appeals for the Ninth Circuit below in *FDIC v. O'Melveny & Myers*, 969 F.2d 744 (9th Cir. 1992).[1]

INTEREST OF AMICI CURIAE

SIPC is a non-profit membership corporation charged with the administration of the Securities Investor Protection Act, 15 U.S.C. §78aaa et seq. ("SIPA" or "the Act"). Section 78ddd of the Act established a fund from assessments on the approximately 8,000 brokerage firms that are members of SIPC. The size of the SIPC fund is more than $790 million. SIPC also is authorized to borrow up to $1 billion from the United States Treasury if SIPC's funds become inadequate to fulfill its statutory purposes. 15 U.S.C. §78ddd(f)-(h).

SIPC is charged with administering the fund to protect customers of failed brokerage firms. In the event of a firm's failure, a trustee specified by SIPC and appointed by a federal district court, and possessing powers similar to those of a trustee in bankruptcy, endeavors to replace customers' securities positions and restore cash in customers' accounts. Customers' claims are paid with advances to the trustee from the SIPC fund, to the extent that they cannot be paid promptly through liquidation of the firm's assets and recoveries from wrongdoers. The liquidation of financially troubled brokerage firms often requires that SIPC and the trustee bring actions against third parties. SIPC and the trustee thus are

[1] This brief *amicus curiae* is filed with the consent of the parties. Copies of their consents are on file with the Clerk of the Court.

involved in proceedings similar to those in the case before the Court.

Eugene W. Bell as Trustee for the Liquidation of Joseph Sebag, Inc., and Laurence A. Schroeder as Successor Trustee for the Liquidation of First State Securities Corporation (referred to collectively as "the Trustees") are duly appointed trustees in ongoing liquidation proceedings in the United States Bankruptcy Courts for the Central District of California and the Southern District of Florida, respectively. These proceedings include an action involving claims by the Trustees and SIPC against insiders of both firms as well as third-party wrongdoers. *Securities Investor Protection Corp. v. Vigman*, Number CV 83-4742 AWT (C.D. Cal. filed July 22, 1983).

The complaint in *Vigman* asserts that insiders of the firms and third party defendants committed fraud and violated RICO and federal securities law and that these acts culminated in the insolvency of the brokerage firms. The district court ruled that the Trustees may not pursue these claims, because the firms in liquidation would be barred from asserting them, due to the misconduct of the firms' insiders. Specifically, the district court held that the insiders' knowledge of wrongdoing was to be imputed not only to the firms, but also to the Trustees, and further that the imputation of knowledge establishes a defense in favor of third party defendants who committed misdeeds that resulted in the insolvency of the firms.

Petitioner in the present case relies on essentially the same theory of imputed knowledge in support of its equitable defense.

SUMMARY OF ARGUMENT

The "imputed knowledge" theory upon which Petitioner bases its equitable defense will interfere with Respondents' responsibilities. The regulatory systems established by Congress to guide the FDIC and SIPC are intended to impose the costs of wrongdoing on the wrongdoers. Imputing the knowledge of former insiders to the receiver or trustee appointed under such a regulatory system would shield wrongdoers from the consequences of their misdeeds and damage the important public interests at stake.

Even when considered solely under state law, the knowledge of former insiders should not be imputed to Respondents. The court of appeals sought to reconcile state and federal law and gave due consideration to both.

ARGUMENT

I.

THE ABILITY OF *AMICI* TO FULFILL THEIR STATUTORY RESPONSIBILITIES MAY BE HAMPERED IF THIS COURT ENDORSES PETITIONER'S "IMPUTED KNOWLEDGE" THEORY.

Petitioner argues that knowledge of the former officers and directors of the failed financial institutions should be imputed to the institution and thence to the receiver. The same imputed knowledge theory has been raised as a shield to claims brought by trustees against third-party wrongdoers in SIPC liquidation proceedings. Should the Court endorse a defense based on this theory, the effect will reach SIPA trustees and will prevent them from fulfilling their statutory responsibilities.

"Congress enacted the SIPA to . . . restore investor confidence in the capital markets, and upgrade the financial responsibility requirements for registered brokers and dealers." *SIPC v. Barbour*, 421 U.S. 412, 415 (1975). When SIPC determines that a member firm is in danger of failing to meet its obligations to customers and that there exists one or more of the conditions specified in 15 U.S.C. §78eee(a)(3),[2] SIPC may apply to a court of competent jurisdiction for a protective decree. *Id.* The district court then acquires exclusive jurisdiction over the SIPC member firm and its property, wherever located. *Id.* §78eee(b)(2). SIPC may specify a trustee who shall be appointed by the court. *Id.* §78eee(b)(3). "The trustee is empowered and directed by the Act to return customer property, complete open transactions, enforce rights of subrogation, and liquidate the business of the member. . . ." 421 U.S. at 417. The proceedings conducted by the trustee are directed at the goal of the Act itself: "to afford protection to public customers in the event broker-dealers with whom they transact business encounter financial difficulties and are unable to satisfy their obligations to their public customers." *SEC v. Alan F. Hughes, Inc.*, 461 F.2d 974, 977 (2d Cir. 1972).

Critically important to this regulatory goal is the ability of SIPC and the trustee to pursue claims

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[2] The *Barbour* decision referred to sections of SIPA as they existed prior to the amendment of SIPA in 1978. The sections of SIPA referred to herein are to the amended statute and are not substantially changed from the sections referred to in *Barbour*.

against the individuals who caused the brokerage firm to fail. The trustee is authorized under section 78fff(g) to receive assignments of claims from customers in such form as the trustee determines. The trustee's general powers also permit him or her to litigate claims on behalf of the corporation. *See FDIC v. McSweeney*, 976 F.2d 532, 540 (9th Cir. 1992) (FIRREA's creation of federal cause of action does not limit availability of state law claims), *cert. denied*, ___ U.S. ___ , 124 L. Ed. 2d 658 (1993); *Koch Refining v. Farmers Union Central Exchange, Inc.*, 831 F.2d 1339, 1344 (7th Cir. 1987) (bankruptcy trustee may assert state law claims that could be asserted by corporation or shareholders derivatively), *cert. denied*, 485 U.S. 906 (1988).

The litigation of such claims by SIPC and the trustee is important because, once the customers of the failed firm have been made whole, they have no incentive to pursue the wrongdoers and likely have no standing as well. SIPC and the trustee must hold the wrongdoers liable, or else no one will, and the wrongdoers will go scot-free. Even though the customers have been compensated, this outcome would thwart the "unequivocal Congressional intent to protect the public" that is expressed in SIPC. *In re Donald Sheldon & Co., Inc.*, 153 B.R. 661, 666 (Bankr. S.D.N.Y. 1993). "To the extent that recoveries against wrongdoers are diminished, the assessments against broker-dealers and the costs of investment increase, reducing its attractiveness and impairing the financial health of the nation." *Id.* at 667. *See also*, *In re Application of Executive Secs. Corp.*, 702 F.2d 406, 410 (2d Cir.), *cert. denied*, 464 U.S. 818 (1983) ("Although not formally part of the federal government,

SIPC and its trustees vindicate important public interests.")

This Court previously has recognized the importance of the Trustees' ability to bring such claims. In *Holmes v. SIPC*, 503 U.S. ___ , 112 S. Ct. 1311, 117 L. Ed. 2d 532 (1992), the Court rejected an attempt by SIPC to bring certain claims directly against third parties in that case. The Court's reasoning depended on the Trustees' ability to pursue such claims: "[T]hose directly injured, the broker-dealers, [can] be counted on to bring suit for the law's vindication. . . . [T]he broker-dealers have in fact sued in this case, in the person of their SIPA trustees appointed on account of their insolvency." 503 U.S. at ___ , 117 L. Ed. 2d at 547.

The *Holmes* decision was rendered in a case being litigated by the present *amici*. On remand to the district court, the Trustees continued to litigate their claims against third party defendants. However, the district court recently granted summary judgment to certain of those defendants on the grounds that the knowledge of insiders of the failed brokerage firms must be imputed to the firms and to the Trustees themselves. The district court adopted the position recommended by Petitioner in the present case. This imputed knowledge theory has prevented the Trustees from holding third parties accountable for their misdeeds and will prevent the vindication that this Court anticipated in *Holmes*.

In the present case, the imputed knowledge issue arises in the context of an equitable estoppel. However, the potential defenses based on imputed knowledge are legion. Third party wrongdoers could assert other affirmative defenses, such as indemnification or

contributory negligence. *See Comeau v. Rupp*, 810 F.Supp. 1127, 1142-43 (D. Kan. 1992). Imputed knowledge also could be used to attack reliance, causation, or some other element of the cause of action that the trustee or receiver otherwise could prove; the third party wrongdoers used this tactic in *SIPC v. Vigman*. Third party wrongdoers also could attack the standing of the trustee or receiver. *See Kempe v. Monitor Intermediaries, Inc.*, 785 F.2d 1443, 1444 (9th Cir. 1986) (per curiam).

The imputed knowledge theory could be used to disable trustees and receivers seeking to recover the looted assets of failed brokerage firms and financial institutions, thus relieving wrongdoers of the costs of their misdeeds. This Court should not endorse a theory that would permit such results.

II.

THE COURT OF APPEALS' JUDGMENT MAY BE AFFIRMED ON STATE LAW GROUNDS.

Petitioner interprets the judgment of the Court of Appeals for the Ninth Circuit as creating a conflict between federal law and state law. If a conflict exists, *amici* agree with Respondents and respectfully urge this Court to resolve it in favor of affirming the judgment below. However, *amici* believe that the judgment of the court of appeals serves the objectives of state tort law and gives proper weight to the long-recognized responsibilities of receivers and trustees charged with administration of a regulatory scheme. This position is consistent with Respondents' argument that federal law supports affirmance. *Amici* and Respondents rely on some of the same court decisions in presenting these complementary arguments.

The FDIC represents the public. The statutes governing the FDIC's powers and authorities "should be given a practical construction, and one which will enable the agency to perform the duties required of it by Congress." *FDIC v. Sumner Financial Corp.*, 451 F.2d 898, 904 (5th Cir. 1971), *reh'g denied*; *Comeau*, 810 F.Supp. at 1142; *Resolution Trust Corp. v. Youngblood*, 807 F.Supp. 765, 771-72 (N.D. Ga. 1992).

As the court of appeals below properly ruled, important federal interests should not be sacrificed when a conflict with state laws arises. However, the court of appeals attempted to reconcile state and federal law, as it has in other cases, by rendering a decision that gives due respect to the aims and priorities of both. *See, e.g., FDIC v. McSweeney*, 976 F.2d at 538-40 (FIRREA's creation of cause of action against officers and directors of financial institutions for gross negligence does not limit FDIC's authority to bring state law claims that require lesser showing of fault); *Home Savings Bank, F.S.B. v. Gillam*, 952 F.2d 1152, 1156-57 (9th Cir. 1991) (RTC's general statutory authority to put insured institutions in sound and solvent condition defeats argument that bank may not sue its former officers and directors).

The United States Court of Appeals for the Seventh Circuit has applied a similar analysis. In *Cenco, Inc. v. Seidman & Seidman*, 686 F.2d 449 (7th Cir.), *cert. denied*, 459 U.S. 880 (1982), the court considered the twin objectives of tort law to "compensate the victims of wrongdoing and to deter future wrongdoing." 686 F.2d at 455. The court recognized that permitting a corporation to hold its auditors liable for misconduct in which the corporation's own former management participated would serve neither of these goals, be-

cause any recovery would accrue to the benefit of the corporations's shareholders, who had failed to detect the former management's misdeeds. *Id.* at 456.

In a later case, the court considered these same objectives of tort law in a situation similar to that presented in the case at bar. In *Schacht v. Brown*, 711 F.2d 1343 (7th Cir.), *cert. denied*, 464 U.S. 1002 (1983), the Illinois Director of Insurance brought claims as liquidator of a failed firm against the firm's former accountants and others. The court recognized that the tort objectives stated in *Cenco* would be served by permitting the Director to pursue those claims. 711 F.2d at 1348-49.

Like the Illinois Director of Insurance in *Schacht*, the FDIC in the present case is appointed under the authority of a regulatory statute and is endowed with a public mission. The public interests at stake are more important than the purely private interests considered in *Cenco*, or in cases involving claims by the trustee of a debtor's estate in bankruptcy. *See, e.g.*, *In re Investors Funding Corp. of New York Securities Litig.*, 523 F.Supp. 533, 540-41 (S.D.N.Y. 1980). As *Schacht* illustrates, the key consideration is not whether a receiver or trustee wields federal statutory authority, but whether the receiver or trustee is bringing its claims in furtherance of a regulatory system designed to protect the public interest. Both state and federal law should be interpreted to vindicate the public interests at stake, to compensate victims, to impose the costs of wrongful acts on those who committed the acts, and to deter future wrongdoing. The court of appeals did so in the present case, and the judgment should be affirmed.

CONCLUSION

For the foregoing reasons, the judgment of the United States Court of Appeals for the Ninth Circuit should be affirmed.

Respectfully submitted,

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